



Treasury Inspector General for Tax Administration

IMPROVEMENTS HAVE BEEN MADE TO MONITOR EMPLOYERS THAT USE PROFESSIONAL EMPLOYER ORGANIZATIONS, BUT MORE CAN BE DONE

Issued on September 19, 2007

Highlights

Highlights of Report Number: 2007-30-169 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

A Professional Employer Organization (hereafter referred to as a PEO or Organization) may enter into contracts with numerous companies (clients) and is responsible for paying employment taxes on wages paid to leased employees. If the Organization fails to pay these employment taxes, large tax underpayments can occur in a short time span because of the large number of employees that are affected. If the Organization defaults on paying the employment taxes, it usually does not have significant assets to collect against because it is only a service company. The Internal Revenue Service's (IRS) only recourse may be to collect the amounts due from clients of the Organizations, which could result in significant additional expense for the clients who have already paid fees to the Organization to cover the costs of those payroll taxes.

WHY TIGTA DID THE AUDIT

This audit was initiated because tax compliance by PEOs is a growing area of risk. Instances of PEOs defrauding their clients are becoming more prevalent. For example, on December 7, 2004, the Chief Executive Officer of a large Organization pled guilty to conspiring to defraud the United States by underreporting and underpaying in excess of \$51 million in Federal employment taxes to the IRS. In another case, the president of an Organization was prosecuted for failing to pay over to the IRS more than \$13 million in payroll taxes for more than 6,000 leased employees.

The overall objectives of this review were to determine the steps the IRS is taking to address PEOs that default on paying employment taxes and to determine what can be done to improve compliance tracking for those businesses that terminate their use of these Organizations.

WHAT TIGTA FOUND

The Office of Taxpayer Burden Reduction of the IRS Small Business/Self-Employed Division convened a task force which recommended changes to some of the forms and procedures used by the IRS to control Organizations. TIGTA agrees with the corrective actions taken as a result of the task force as an important step in getting this compliance issue under control. However, TIGTA also found that current regulations do not protect clients when Organizations default on paying employment taxes. The Federal Government currently does not require bonding of Organizations, like many States do, and does not require independent quarterly tax payment reviews and annual financial reviews of Organizations.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Commissioner, Small Business/Self-Employed Division, and the IRS Office of Chief Counsel work with the Office of Tax Policy in the Department of the Treasury to (1) consider a legislative proposal requiring all current and future PEOs to become certified, which would include posting a bond for payment of taxes; and (2) explore all options to establish accurate links between the PEOs and their clients. In addition, the Commissioner, Small Business/Self-Employed Division, should fully implement the changes proposed by the task force requiring the Employer's Quarterly Federal Tax Return (Form 941) to list clients, and ensure outreach efforts are adequate to sufficiently inform taxpayers of the potential risks of using a PEO, which include remaining liable for employment taxes left unpaid by the PEOs.

In their response to the report, IRS officials agreed with the recommendations and plan to work with the Office of Tax Policy in the Department of the Treasury to consider a legislative proposal applicable to PEOs addressing certification and bonding requirements as well as other requirements, such as reviews of quarterly tax payments and annual financial reviews. The IRS also plans to work with the Department of the Treasury to explore all options to establish links between PEOs and their clients. The Director, Specialty Programs, Small Business/Self-Employed Division, plans to explore a proposal for PEOs to provide a list of every client whose wages the organization is reporting to the IRS and will work to develop a mechanism requiring this information. The Director, Communications, Liaison and Disclosure, Small Business/Self-Employed Division, plans to develop an outreach initiative to small business/industry groups that addresses employment tax obligations when the services of a PEO are used.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2007reports/200730169fr.pdf>.

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